

## Message Text

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ACTION EA-14

INFO OCT-01 EUR-25 ISO-00 SEC-03 SPC-03 SAM-01 AID-20

EB-11 NSC-10 RSC-01 CIEP-02 TRSE-00 SS-20 STR-08

OMB-01 CEA-02 CIAE-00 COME-00 FRB-02 INR-10 NSAE-00

XMB-07 OPIC-12 LAB-06 SIL-01 L-03 PA-04 PRS-01 USIA-15

DRC-01 /184 W

----- 130787

R 220210Z FEB 74

FM AMCONSUL HONG KONG

TO SECSTATE WASHDC 9661

INFO AMEMBASSY TOKYO

AMEMBASSY TAIPEI

AMEMBASSY SEOUL

AMEMBASSY MANILA

AMEMBASSY SINGAPORE

AMEMBASSY LONDON

AMEMBASSY JAKARTA

LIMITED OFFICIAL USE HONG KONG 1954

E.O. 11652: N/A

TAGS: EFIN

SUBJECT: NEW LEGISLATION REGULATING STOCK EXCHANGES, DEALERS,  
TRADING AND PROTECTION OF INVESTORS

DEPARTMENT PASS TREASURY, FEDERAL RESERVE AND SECURITIES  
EXCHANGE COMMISSION

1. SUMMARY: NEW LEGISLATION REGULATING OPENING AND OPERATION OF  
STOCK EXCHANGES, TRADING PRACTICES, PROTECTION OF INVESTORS FROM  
MISLEADING INFORMATION, ETD., HAS PASSED LEGISLATIVE COUNCIL.  
SECURITIES COMMISSIONER AND SECURITIES COMMISSION HAVE BEEN  
ESTABLISHED TO REGISTER DEALERS AND MONITOR MARKETS. THIS FIRST  
ATTEMPT ESTABLISH REGULATORY FRAMEWORK IN HONG KONG'S TRADITIONALLY  
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LAISSEZ-FAIRE ECONOMY. IT IS MAINLY RESULT OF STOCK MARKET CRASH

LAST SPRING. IT SHOULD, OVER TIME, GRADUALLY RESTORE SOME  
CONFIDENCE IN LOCALLY LISTED SECURITIES. END SUMMARY.

2. BEGIN UNCLASSIFIED. BACKGROUND - UNTIL NOW ALL ASPECTS OF  
SECURITIES TRADING HAVE BEEN COMPLETELY UNREGULATED. NO OFFICIAL  
PERMISSION WAS NEEDED TO ESTABLISH A STOCK EXCHANGE, BECAUSE BROKER,  
SELL SHARES OR DISPENSE INVESTMENT ADVICE. UNTIL A FEW  
YEARS AGO, SECURITIES INDUSTRY WAS SMALL AND ONLY HONG KONG STOCK  
EXCHANGE EXISTED. IN LAST THREE YEARS, THREE NEW EXCHANGES WERE  
ESTABLISHED, NUMBER OF DEALERS ROSE FROM LESS THAN ONE HUNDRED  
FIFTY TO MORE THAN ONE THOUSAND AND STOCK TRADING WENT THROUGH  
1929 STYLE BOOM AND CRASH (AVERAGE INDEX FOR 1971 282, PEAK INDEX  
OM2/73 OF 1626 AND 12/73 INDEX OF 434). RECENT EXPERIENCE TOOK OUT  
OBSCURITY STUDIES OF COMPANY REFORM LAW BEGUN TEN YEARS AGO.  
UNDER DIRECTION ACTING COMMISSIONER OF SECURITIES AND SECURITIES  
ADVISORY COMMISSION, LEGISLATION WAS DRAWN UP AND PRESENTED TO  
LEGISLATIVE COUNCIL LAST FALL. IT HAS NOW PASSED AFTER NUMEROUS  
MINOR AMENDMENTS AND SOME DILUTION OF HKG ORIGINAL AIMS.

3. PRINCIPAL ACCOMPLISHMENTS - TWO LAWS - SECURITIES ACT AND  
PROTECTION OF INVESTORS ACT ACCOMPLISH FOLLOWING OBJECTS:

(A) REQUIRE REGISTRATION AND THUS OFFICIAL PERMISSION FOR THE  
ESTABLISHMENT OF STOCK EXCHANGES, SECURITIES DEALERS, AND  
INVESTMENT ADVISORS;

(B) ESTABLISH COMMISSIONER OF SECURITIES AND SECURITIES  
COMMISSION WITH STAFF TO ACT AS POLICING AND RULE-MAKING  
AUTHORITY;

(C) PROVIDE FOR COMPENSATION FUND TO BE SET UP BY EXCHANGES  
TO MAKE GOOD INVESTOR LOSSES CAUSED BY DEALER FRAUD;

(C) MAKE IT CRIME TO ADVERTISE OR OTHERWISE DISSEMINATE  
FALSE OR MISLEADING INFORMATION ABOUT SECURITIES; AND

(E) OUTLAW CERTAIN TRADING PRACTICES. END UNCLASSIFIED.

4. BEGIN LIMITED OFFICIAL USE - COMMENT: BASIC PHILOSOPHY IS  
TO REGULATE TRADING AND TRADERS TO MAKE THEM MORE HONEST. NEW  
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LAWS DO NOT ATTEMPT FKDEISH MORE INFORMATION ON COMPANIES THAN WAS  
ALREADY AVAILABLE. CURRENT LIMITS ON POTENTIAL EXTENT OF REGULA-  
TORY ACTIVITY ARE ILLUSTRATED BY MOST AMBITIOUS PROVISION OF ORIGINAL  
BILL, TO MAKE IT CRIME, PUNISHABLE BY IMPRISONMENT, TO USE INSIDE  
INFORMATION FOR PROFIT IN TRADING. IT RAN INTO SO MUCH OPPOSITION  
THAT ONLY PRINCIPLE WAS AFFIRMED IN LAW BUT IMPLEMENTATION WAS  
SUSPENDED. COMBINATION OF INTERLOCKING DIRECTORATES, CHINESE CUSTOM  
OF REPRESENTING FAMILY GROUP. USE OF MONIMEE ACCOUNTS ("STREET NAMES")

OPERATED BY BANKS, AND VERY SMALL STAFF THAT COMMISSIONER WILL HAVE, WOULD HAVE MADE IT VERY DIFFICULT TO ENFORCE. MORE GENERALLY, HKG WILL NOT TRY TO GO BEHIND TRADING PRACTICES BECAUSE STRONGLY CONSERVATIVE, BUSINESS DOMINATED HONG KONG COMMUNITY WILL NOT GIVE IT AUTHORITY TO DO SO WITHOUT DAMAGING STRUGGLE. STOCK EXCHANGES AND OTHERS CONNECTED TO SECURITIES BUSINESS REMAIN SOMEWHAT HOSTILE TO WHOLE UNDERTAKING AND CAN BE EXPECTED TO PROVIDE MINIMAL COOPERATION.

5. NEW COMMISSIONER IS SERIOUS AND ABLE AND HAS SUPPORT OF FINANCIAL SECRETARY AND ORGANIZATIONS LIKE HONG KONG AND SHANGHAI BANK. BUT HE IS HANDICAPPED BY SMALL STAFF. OVER TIME, OPERATION OF COMMISSIONER AND COMMISSION SHOULD GRADUALLY RESTORE DEGREE OF CONFIDENCE OF OVERSEAS INVESTORS WHO HAVE, CORRECTLY, THOUGHT OF HONG KONG AS FREE-FOR-ALL WHERE ONE CAN ONLY HOPE FOR QUICK TRADING PROJECTS NOT LONGER TERM INSTRUMENT. END LIMITED OFFICIAL USE  
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